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L3 l1 and (offline (off-line) (off adj line)) near (limit and balance)

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☐ Banks Enter A New Debit Market, And AmEx Has Its Foot In The Door

Date: November 30, 1998

11/6,K/1 (Item 1 from file: 9)
01715057 Supplier Number: 24461942
Banks Enter A New Debit Market, And AmEx Has Its Foot In The Door

November 30, 1998
Word Count: 1384

(American Express, although a niche debit player, has entered the **prepaid** gift cards arena)

ABSTRACT:

American Express, although a niche debit player, has entered the **prepaid** gift cards arena. Usually, **prepaid** gift cards are managed by third parties or in-house. AmEx started managing **prepaid** gift card programs for Chanel Inc's 16 Chanel boutiques and for Tower Records' 217 video, book and record stores.The Visa-branded gift cards are available only as an additional service to First USA's 50 mil Visa credit cardholders, while the **MasterCard**-branded gift card is available to anyone through Swift Gift Ltd. **Prepaid** gift cards replace paper gift certificates, which generate $13 bil/yr in sales. Pricing structures and dividing proceeds of **prepaid** gift cards are discussed.

TEXT:

MasterCard International and Visa U.S.A., whose brands compete alone for offline debit card market share, now find themselves competing in a new debit arena: **prepaid** girl cards. This time, though, American Express Co., the leading corporate card company but still a niche debit player, is joining the fray.

Traditionally, **prepaid** gift card programs are restricted by merchants to their own initiatives and are managed either in-house or by third parties that specialize in transaction...
Indeed, the AmEx gift card program is designed to compete with such operations. The company in November began managing **prepaid** girl card programs for New York City-based Chanel Inc.'s 16 Chanel boutiques and for West Sacramento, Calif.-based Tower Records' 217 record, video and book stores worldwide. AmEx expects to add more merchants early in 1999.

Though the **MasterCard**- and Visa-branded initiatives are "universal" in that the gift cards carrying their logos are usable at any merchant location that takes their offline debit and credit cards, their purpose and eligibility rules differ. The **MasterCard**-branded gift card, issued by Cleveland-based KeyBank, is available to any consumer through Highland Park, Ill.-based Swift Gift Ltd., while the Visa-branded ...

...consumer-acceptance and other problems. California, for example, does not allow expiration dates on gift certificates. Moreover, point-of-sale terminals typically cannot provide card-**balance** information for **offline** debit transactions, which potentially could cause customer-service problems for issuers and merchants when cardholder transactions are declined.

Prepaid gift cards are designed to replace paper gift certificates, whose handling, record-keeping and processing are costly and time consuming to merchants. Though paper gift...

...is stored on or accessed via the cards--and transactions are processed electronically. Each of the three nationally branded cards has a magnetic stripe.

The **prepaid** gift card industry has become big business, and the emergence of international players suggests that they or their member issuers want a piece of the...

...of the Dove Associates consulting firm. "On average, consumers spend 30% to 35% more than the face value of the certificate. And like any other **stored-value** card there is 'breakage' where value is never redeemed--about 5% of the value stored by our estimates--which represents a lot of money."

For...

...cards during the current holiday season, says Jennifer Hegji, vice president of training and education.

The chief advantage to converting from paper gift certificates to **prepaid** plastic cards is the enhanced ability to maintain and track customer data, Hegji says.
While AmEx expects the gift card program to enhance its retail...

...after the issue date, and unused portions are returned to the cardholder via a mailed check, the spokesperson says.

Though KeyBank is issuing the first **prepaid** gift card that can be used to initiate transactions at any of the more than 15 million retail locations that accept **MasterCard**, it was two grandmothers who came up with the concept, Carol Jacobsohn and Nancy Ginsberg. They drew up the business plan, convinced **MasterCard** to put its brand name on the Swift Gift Card and started Swift Gift Ltd. They rolled out the product earlier this month.

"We had...

...a feel for the product and seemed to be eager to be the issuer," Jacobsohn says. The card's interchange rate is the same as **Mastercard**'s offline MasterMoney card. The standard MasterMoney interchange rate is 1.36% of the transaction amount.

The non-reloadable Swift Gift Card can be acquired...

...22 discussed the topic but came up with no recommendation. The Fed is expected to take up the issue next year when it considers enacting **stored-value** card regulations.

While proponents of such universally accepted cards say the plastic provides greater choice for cardholders, some organizations that have explored that market found...

...addition to not being able to provide cardholders with card-balance information at the point of sale, says T. Jack Williams, senior vice president at **Stored Value** Systems Inc., the Louisville, Ky.-based subsidiary of National City Bank that manages **prepaid** gift card programs for The Gap, Kmart and other merchants, other problems can arise. If merchants are unable to authorize transactions immediately, for example, card...

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☐ The Impact of Fraud on New Methods of Retail Payment

Date: First Quarter 1998

11/6,K/2 (Item 2 from file: 15)
01632517 02-83506
**

The Impact of Fraud on New Methods of Retail Payment

First Quarter 1998 **Length:** 11 Pages
Word Count: 7859
Text:

...their overall integrity has been maintained.

This article explores the potential impact of fraud on new forms of retail payment such as electronic cash and **stored-value** cards. These new payments media can increase economic efficiency by incorporating advances in computer technology into payments systems. Payments systems based on these new media...the estimates imply a fraud rate of between 10 and 20 basis points (0.1 to 0.2 percent). In the case of bank cards (**MasterCard** and Visa), a study by the American Bankers Association (1996) estimated total gross fraud loss for 1995 at 8790 million versus purchases of $451 billion...debit card is reported within two days and at $500 if the loss is reported within sixty days. Recently the two main debit card issuers, **MasterCard** and Visa, have announced policies that place more stringent limits on cardholders' liability (see Fickenscher 1997 and Keenan 1997). Under these new policies, cardholders' liability...

...Recently a number of new retail payment technologies have become available (some of which are still undergoing trial). Among the most widely discussed technologies are **stored-value** cards and a group of technologies that fall under the term on-line payments. 11

A **stored-value** card is a payment card similar in appearance to a credit or debit card. To use a storedvalue card, a buyer must first purchase a...

...issuer then stores the value of this purchase on the card itself, in the form of data contained on a magnetic stripe or an electronic

chip. A buyer can then purchase goods by presenting the card to a seller, who electronically transfers the value on the card to the seller's...

...electronic messages that represent a financial claim on its issuer.12

In many ways, these new forms of payment closely resemble traditional forms. For example, **stored-value** cards have many features in common with travelers' checks, and credit card payments over the Internet are obviously not so different from credit card payments... allow buyers and sellers to identify one another over the Internet and also to prevent unwanted eavesdropping on private transactions.

A similar difficulty exists with **stored-value** cards. These cards are designed to be used for small-dollarvalue transactions, particularly transactions in which traditional methods of verification are too costly or otherwise impractical. Instead, verification is provided by data contained on the card itself (perhaps in combination with on-line information). In this sense, **stored-value** payments systems may be seen as an electronic analog of currency, where validity of the payments medium is provided by visual inspection. As is the case with currency, this feature of **stored-value** cards increases the incentives for counterfeiting and fraud. **Stored-value** systems rely on electronic encryption technologies to protect against counterfeiting and other fraudulent use.'4

Incentives for fraud are magnified in the case of those **stored-value** cards that allow for "peer-to-peer" transactions, that is, transactions among cardholders who do not have access to on-line verification or clearing technologies. In this type of system, value can be successively transferred from one **stored-value** card to another without outside verification. This feature can increase the time interval between counterfeiting or possible fraudulent use of the card and the subsequent detection of fraud when the **stored value** is ultimately presented for redemption.

The issue of who bears the responsibility for fraud is unresolved for many of the new payments media. For many...

...the risk associated with fraud losses.

Counteracting this incentive are potential difficulties resulting from anonymity of some of the new payments media, particularly for some **stored-value** cards. For example, if a **stored-value** card is issued anonymously there is no way to identify the rightful owner of the card. It would thus be difficult if not impossible for the issuer of the card to stop payment on a lost or stolen card, given the current design of **stored-value** systems.lb In such situations, users of **stored value** cards would have an incentive to handle these cards with the same care as if they were currency.

What Could Go Wrong

A recent episode...

...provides some sobering lessons concerning the potential for fraud over new payments systems (see Glain and Shirouzu 1996 and Pollack 1996). This case concerns a **stored-value** card designed by Sumitomo Corporation and Mitsubishi Corporation, with the cooperation of Nippon Telephone and Telegraph as well as various government agencies. The cards were...

...Criminal organizations were able to defeat the encryption by cloning, that is, by transferring the data stored on existing cards to used cards. The cloned **stored-value** cards were then taken to

pachinko parlors and redeemed for cash. Since the **stored-value** issuers had no way to distinguish fraudulent transactions from legitimate transactions, they were forced to absorb the resulting losses. Published reports estimate the losses from this episode were at least $600 million.
The pachinko fraud is instructive in that it illustrates the power of incentives. Although the pachinko **stored-value** cards were heavily encrypted, various features of their design created strong incentives for fraud. Apart from the obvious defect of being too easy to copy...

...and cracking down on pachinko parlor operators who had apparently tolerated extensive use of cloned cards."

Historical Lessons

Various analyses of new payments media (particularly **stored-value** cards and electronic cash) have invoked comparisons of the new media with the banknotes that circulated during the U.S. Free Banking Era (1837-65...As discussed above, the "network" economics of the new payments media are likely to limit credit risk associated with new forms of payment. Holders of **stored-value** cards, for example, would prefer to use **stored-value** cards that are readily acceptable in as many places as possible. Providers of **stored-value** cards and similar payments systems therefore have incentives to form broad coalitions with a widely recognizable brand name. The members of such coalitions have strong...

...Corporation (FDIC) insurance of a payment instrument. As of this writing, however, it appears that FDIC insurance will not be provided for most types of **stored-value** cards. The FDIC has also requested comment on the eligibility of certain other forms of electronic payment for deposit insurance; see FDIC (1996).

The Free...

...also been expressed that premature regulation of new payments media may hinder the development of potentially more efficient payments systems.24

In the case of **stored-value** cards, the Federal Reserve has attempted to avoid excessive regulatory burdens on new payments technology by proposing that Regulation E not apply to certain types of **stored-value** cards (see Board of Governors 1996a, 1997a). Currently, Regulation E requires that consumers be provided written records for electronic funds transfers and limits consumer liability...

...use an "access deice" to withdraw or transfer funds from a "consumer asset account." While withdrawals from such an account in order to load the **stored-value** card would be covered by Regulation E, the proposed regulations wuld not be extended fully to all transactions between buyers and sellers involving **stored-value** cards. For example, the Federal Reserve proposal would exempt from these provisions all cards containing $100 or less, as well as all cards that are
...be desirable in some situations in that they allow for a greater range of transactions, they can also encourage fraud. The recent Japanese experience with **stored-value** cards illustrates that vigilance will be necessary in such cases.

Some of the new payments media have been compared with the banknotes used during the...

...may be either "on-line" or "off-line. With on-line cards, a transaction is verified by comparing the purchase amount against a buyers bank **balance**. With **off-line** cards, the transaction is verified by comparing the buyers total purchases over a certain period against a preset limit.

I1. These technologies are extensively discussed...

...this scenario is laid out in McAndrews (1997b). More generally, see
Weinberg (1997) on network effects in payments systems.

Footnote:

16. See Task Force on **Stored-Value** Cards (1997, 715
20) or Board of Governors (1997a, 52)for a discussion of these issues. 17
Stored-value cards that make use of data stored on
magnetic strips are generally viewed as less secure than cards on which

the data is stored on an electronic **chip**.

18. While it was difficult to detect individual fraudulent cards during
this episode, the widespread use of such cards was public knowledge.
According to Pollack...Subcommittee on Domestic and International Monetary
Policy, U.S. House Committee on Banking and Financial Services, October 11.
BLOOM, JENN[FER KINGSON. 1997. Visa and **MasterCard** Publish: SET
Protocol for Internet."American Banker, June 5. BOARD OF GOVERNORS OF THE
FEDERAL RESER

'E SYSTEM. 1996a. "Electronic Funds Transfers. Federal Register 61...

...and Check Fraud at Depository Institutions. Washington, D.C.

Reference:

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Transfer Act to Electronic **Stored-Value** Products.
Washington, D.C.

. 1997b. Report to Congress Concerning the Availability of Consumer
Identifying Information and Financial Fraud. Washington, D.C. CALOMIRIS,
CHARLES W., AND...

...Panics, and Free Banking in the United States." Federal Reserve Bank of
Atlanta Economic Review 81 (December): 1-20.

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FEDERAL DEPOSIT INSURANCE CORPORATION. 1996. **Stored-Value** Cards and Other Electronic Payments Systems"Federal
Register 61 (August 2): 40494-97.

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Liability."American Banker, July 31. FRYER, BRONWYN. 1996. Visa Cracks Down
on Fraud. Information Week, August 26.

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GLAIN, STEVE...

...Federal Reserve Bank of Kansas City Economic Review 82 (Fourth Quarter):
59-84.

SURVEY OF ELECTRONIC COMMERCE. 1997. Economist, May 10.
Reference:

TASK FORCE ON **STORED-VALUE** CARDS. 1997. aA Commercial
Lawyer's Take on the Electronic Purse: An Analysis of Commercial Law Issues
Associated with **Stored-Value** Cards and Electronic
Money." Business Lawyer 52 (February): 653-727.

Reference:

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View: HTML | PDF | Word

☐ A survey of selected federal regulatory and legal developments in electronic financial services

Date: Nov 1997

11/6,K/3 (Item 3 from file: 15)
01623591 02-74580
**
A survey of selected federal regulatory and legal developments in electronic financial services

Nov 1997 **Length:** 55 Pages
Word Count: 22168
Text:

...but of the other regulatory bodies as well.

FDIC ACTIONS
Insured depository institutions are increasingly utilizing technology to offer customers new retail payment systems, including **stored-value** products 16 and computer network-based products.17 These emerging forms of electronic payments raise several issues with regard to the interpretation and application of existing FDIC laws and regulations. At a basic level, it is necessary to determine whether the value underlying **stored-value** products fits within the statutory definition of "deposit."18 This will depend largely upon two factors: first, the type and design of the card, computer...

...information to identify an account, an account holder, and the nature of any fiduciary or deposit relationship between the consumer and the issuer of the **stored-value** obligation.I9 Once the FDIC decides that the product is a "deposit," the issue arises as to whether it is an "insured deposit."20 Whether deposit insurance covers the new forms of electronic payment is a prominent concern for depositors and other consumers of **stored-value** products, as well as for banks, non-banks, and the entire financial system.

(Chart Omitted)

Captioned as: Federal Regulation and Supervision of Banks and Thrifts... payments systems raises new safety and soundness concerns, the FDIC published new examination procedures in an effort to address those concerns.23

DEPOSIT INSURANCE AND **STORED- VALUE** PRODUCTS

The FDIC, in its General Counsel Opinion No. 8 (FDIC Opinion or Opinion), addressed and clarified whether federal deposit insurance applies to the unpaid...

...by consumers.24 Issued on August 2, 1996, the FDIC Opinion presents the FDIC General Counsel's first official formal regulatory action in regard to **stored-value** products.25 Specifically, the Opinion describes the FDIC's legal position on whether, and under what circumstances, the funds underlying SVCs may be considered "deposits" under the FDIA26 and therefore are assessable and qualify for deposit insurance coverage.

The Opinion identifies four types of **stored-value** systems: (i) a Bank Primary-Customer Account System; (ii) a Bank Primary-Reserve System; (iii) a Bank Secondary-Advance System and (iv) a Bank Secondary...

...the Bank Primary-Reserve System are not insured deposits.29 In making this determination, the FDIC reasoned that in Bank Primary-Customer Account Systems, the **stored value** remains in the customer's account until the payee makes a claim on the funds, whereas in Bank Primary-Reserve Systems, funds are removed from...

...that the FDIC reviewed also did not indicate that the parties to the agreement, the insured depository institution and the purchaser of value, intended the **stored-value** funds to fit within the statutory definitions of "deposit."31 Further, the FDIC found that the funds underlying a Bank Primary-Reserve System are not...

...reaching this conclusion under the "special purpose" prong of the FDIA's definition of "deposit," the FDIC provided the following characterization of Bank Primary-Reserve **stored-value** systems:

[A] customer [in a Bank Primary-Reserve System] who transfers funds to an institution in exchange for electronic value may engage in any of...

...by an institution to redeem electronic value could be associated with general or miscellaneous unrelated transactions.32

The FDIC Opinion concluded that funds underlying the **stored value** in neither the Bank Secondary-Pre-Acquisition Systems nor the Bank Secondary-Advance Systems qualify as insured deposits. With regard to a Bank Secondary-Pre-Acquisition System, the FDIC reasoned that the funds underlying the **stored value** are not "received or held by a depository institution" within the meaning of either 12 U.S.C. . 1813(l)(1) or (1)(3). In...

...institution in effect advances these funds on behalf of its customers and later collects funds from its customer in exchange for electronic value loaded onto **stored value** cards."33 On the other hand, the FDIC found that funds in a Bank Secondary-Advance System, where the funds are held by an institution...further.39

The FDIC Opinion represents a major step in the process of applying existing law and regulations to new and still evolving technologies of **stored-value** and computer network payment systems. As currently constructed, the Opinion seems to provide flexibility to electronic commerce pioneers to structure products outside the regulated environment...approved activity, yet chose not to. The Integrion proposal also met the public benefit test.114

FRB ACTION CONCERNING THE ELECTRONIC FUNDS TRANSFER ACT AND **STORED-VALUE** PRODUCTS

Consumers are exposed to a variety of risks when using electronic retail payment systems, including the risk of loss, unauthorized access or use by ...
...related to electronic accounts may require more time to investigate, the FRB proposed providing adjustments and exceptions for such accounts in the amended Regulation E.

Stored-Value and Electronic Funds Transfer Rules

In what the FRB staff described as a "lighthanded" approach, the FRB proposed to largely exempt offline and low denomination **stored-value** products from the requirements of Regulation E. According to remarks by a FRB member, the rationale for the Regulation E Proposal is that most of...

...small amounts of money and, thus, do not pose inordinate risks to consumers. 122 Noting the increased interest of the financial services industry in adopting **stored-value** technologies, the FRB recognized in its Regulation E Proposal that the question of whether **stored-value** systems were covered by Regulation E and

EFTA depends upon "whether a **stored-value** transaction involves an EFT from a consumer's asset account."123 The FRB went on to cite the legislative history of the EFTA124 and section 904(d) of EFTA125 in support of its own discretion to determine the scope of EFTA's coverage to new products such as **stored-value** systems.

Representing a "first cut at a complex issue,"126 the Regulation E Proposal places **stored-value** products into four general categories depending upon the particular architecture and function of the product: (i) cards with a balance of less than $100; (ii...the aggregate amount of transactions for a specific time period (likely on a daily basis) to the financial institution or other entity. By contrast, in **offline** accountable systems, the **balance** of funds available on the SVC is recorded not only on the card, but is also maintained at a financial institution or other location. Transactions...

...unaccountable" systems is not made by defining such terms in the proposed regulation. Rather, it is accomplished by including in the definition of "off-line **stored-value** account" a requirement that the balance of funds be maintained on a separate database as well as the card.134 As a result, if the balance is not maintained on a separate database, the card does not fall within the definition of an offline **stored-value** account.135

The FRB proposed to treat offline accountable systems as involving an account for purposes of Regulation E. In characterizing the nature of this arrangement, the FRB offered the following observation that may be significant to the future legal treatment of **stored-value** products:

As in the case of the traditional consumer deposit account accessed by a debit card, in these **stored-value** card systems, a consumer has the right to draw upon funds held by an institution. The maintenance of a record of value and of transactions...148 Noting the differences in various proposed network-payment systems, the FRB concluded that "the same principles should apply to network payment products as to **stored-value** card products in analyzing coverage under Regulation E."149

The FRB's proposal on the coverage of SVCs generated a substantial amount of commentary from...

...interests. 151 It has also been noted that developing technologies may make it possible for issuers to blend offline and online characteristics in a single **stored-value** product, making it difficult and confusing for consumers, regulators, and courts to determine which category applies to the product. Finally, online SVC systems, which offer ...

...of protection, are the most heavily regulated by the FRB's Regulation E Proposal and, thus, would be disfavored by companies and prospective issuers developing **stored-value** products. Some believe that the FRB should consider whether **stored-value** products should be regulated at all under Regulation E, in light of its historical interpretation not to apply to **pre-paid** services, such as subway tokens, travelers checks, and gift certificates.152

THE FRB **STORED-VALUE** REPORT

In section 2601 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA),153 Congress instructed the FRB to determine whether provisions of the EFTA could be applied to electronic **stored-value** products "without adversely impacting the cost, development, and operation of such products."154 The EGRPRA also directed the FRB to consider whether there exist alternatives...

...the enactment of the EGRPRA, the FRB had proposed amending Regulation E, as previously discussed, such that select Regulation E provisions would apply to certain **stored-value** products.156 The EGRPRA, however, barred the FRB from taking final action on that proposal for a period of either three months from the date...

...enactment of the EGRPRA, September 30, 1996.157

The FRB delivered its Report to Congress on the Application of the Electronic Fund Act to Electronic **Stored-Value** Products (**Stored-Value** Report) on April 2, 1997.158
The **Stored-Value** Report is organized as follows:
I. Introduction and Summary

II. Analytical Framework: The Economics of Innovation, Technology, and Regulation

III. Electronic **Stored-Value** Products and Their Potential Markets

IV Retail Payment Risks and the EFTA

V Potential Costs of Applying Regulation E Requirements to **Stored-Value** Products

VI. Alternative Approaches to Regulating Electronic **Stored-Value** Products 159

Sections II and III, the first two substantive sections of the **Stored- Value** Report, address criticism the FRB received from industry participants regarding its 1996 proposal to explicitly extend the scope of Regulation E to **stored-value** systems. Specifically, critics found the proposal premature and the FRB proposal for categorizing **stored-value** systems unworkable. Section IV then examines who shoulders the risks of using **stored-value** products.
The **Stored-Value** Report next reviews the costs and benefits of various regulatory applications to **stored-value** products. In section V the FRB concludes that "full application of Regulation E would likely impose substantial operating and opportunity costs of compliance."160 Having made that conclusion in section VI, the FRB specifically analyzes the effects of the following four approaches for the selective application of Regulation E to **stored-value** products:

(i) requiring only initial disclosure of information concerning **stored-value** product characteristics,

(ii) uniformly applying a subset of critical Regulation E provisions to all **stored-value** products,

(iii) variably applying selected Regulation E provisions on the basis of product usage or characteristics, and

(iv) variably applying selected Regulation E provisions on...

...basis of the underlying technology's ability to comply with regulatory requirements.161

Following the discussion of these possible selective applications of Regulation E to **stored-value** products, the **Stored- Value** Report presents a number of alternatives to such application, including: (i) relying on the existing legal framework and market incentives in place of regulation;162 (ii) relying on government-issued policy statements;163 (iii) developing governmentsponsored consumer education programs about **stored-value** products;164 and (iv) passing new federal or state legislation to address **stored-value** products and consumer concerns.165 The **Stored-Value** Report does not endorse or recommend any specific course of action, rather it shows that there is no ideal solution for balancing the law, technology, and consumer expectations.

The **Stored- Value** Report's other major findings and conclusions include:

(i) The wide variety of existing and planned **stored-value** products makes it unlikely that a single set of consumer protections would be appropriate for all **stored-value** products.

(ii) **Stored-value** products, if successful, will create an additional payment option that will compete with payment alternatives already well-established among both consumers and merchants.
(iii) **Stored-value** products have the potential to increase the efficiency and security of the retail payment system, but are not likely to be widely accepted for some time.

(iv) In general, **stored-value** products give rise to the same types (but potentially differing degrees) of ...of retail payments including: risk of loss, unauthorized use, processing errors, dishonor, payment mechanism failure, and unauthorized use of consumer-specific payment information.

(v) Certain **stored-value** products fall within the scope of the EFTA and Regulation E; other types of **stored-value** products may not, however, because they do not involve EFTs from consumer asset accounts.

(vi) While early government regulation of **stored-value** products may accelerate **stored-value** product development by removing regulatory uncertainties, it also has the potential to cause higher regulatory costs. Waiting too long to regulate **stored-value** products could prove costly because issuers might be forced to adapt existing regulatory requirements to the emerging products.

(vii) Given the limited experience with **stored-value** products to date, it is difficult to assess the extent to which the benefits to consumers from the application of any particular Regulation E provision might outweigh the corresponding costs of compliance.

(viii) Even partial application of Regulation E's requirements to **stored-value** products could impede development of the new payment products, and thereby adversely influence the payment options available to market participants in the future.

(ix) The existing legal framework provides considerable incentives for providers of **stored-value** products terms to avoid unconscionable or unfair terms and to make adequate disclosures about **stored-value** products.166

A fair reading of the **Stored-- Value** Report suggests that the FRB has left room to consider further the extent to which technological advances affect **stored-value** products and the application of Regulation E to those products. For example, multi-use cards will force regulators to determine how Regulation E applies to...

...financial information as well as medical information). Further, Regulation E may need to address the level of disclosure necessary regarding the security technology employed in **stored-value** products, such as digital signatures, encryption, and certificate authorities.

ELECTRONIC BENEFIT TRANSFERS

The EFTA provides FRB with a broad mandate to determine coverage of the... to compete, and the OCC has recognized that such participation should not be constrained by the formal characterization of the agreement.

OPERATING THE MONDEX ELECTRONIC **STORED- VALUE** SYSTEM

In December 1996, the OCC issued the latest word on permissible joint venture activities in connection with joint ventures of two LLCs formed for the purpose of operating the **stored-value** system operated by Mondex.203 The OCC approved applications from four national banks, each proposing to establish an operating subsidiary that would participate as a...

...proposed system committed to:

(i) "develop and implement asset/liability management policies and procedures. . . to ensure that it is able to purchase the ESV [electronic **stored value**] tendered by Members";207
(ii) limit liability from both accounting and legal perspectives by member agreement, so that no member that is a national bank...to dispense alternative media through their network ATMs. The media forms included: (i) public transportation tickets, (ii) event and attraction tickets, (iii) gift certificates, (iv) **prepaid** phone cards, and (v) similar alternate media such as promotional materials and debit/credit cards.229 The OCC in its response referred specifically to the...identified the many different roles that national banks may play in emerging SVC systems, including: (i) an investing bank (holding an equity stake in a **stored-value** system); (ii) an issuing bank (i.e., the creator of or obligor for electronic cash); (iii) a distributing bank (distributing or selling SVCs to consumers...how the " 'borderless' nature of electronic banking will also affect thrift responsibilities under the CRA [Community Reinvestment Act]."268

Current OTS regulations fail to address **stored-value** technology OTS requested comment on all aspects of **stored-value** technology In addition, OTS requested specific comment on the following questions:

How extensively will the industry use **stored-value** cards? Do certain kinds of **stored-value** programs present greater safety and soundness concerns than others? Do **stored-value** cards present special issues that OTS should consider in examining the liabilities of a savings association? What kind of OTS guidance, if any, is appropriate...guidelines.304

Footnote:

1. For purposes of this Article, the authors define EFS as the movement of value electronically via computer networks and/or microcompressor **chip** cards (smart cards) and/or **stored-value** cards.

Footnote:

2. This Article covers developments up to and including July 1997. 3. See BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION...are not subject to this requirement. Id. 466. 12. Id 321. 13. Id. 1814. 14. Id. 1815.

15. Id. 1831a(a)(1).

Footnote:

16. A **stored-value** card (SVC) and a smart card may
operate much the same with respect to the loading and disbursement of
value. Typically; an SVC card holds...
...payment and access system), and, very often, the card is not reusable or
reloadable. A smart card performs the same functions but uses a
microprocessor **chip** in the card. The **chip** adds an
interactive memory feature to smart card capabilities that is not present
in magnetic stripe SVCs. Usually a smart card is reloadable with respect...

...KUTLER, OVERVIEW OF SMART CARDS AND THE INDUSTRY IN SMART CARDS:
SEIZING STRATEGIC BUSINESS OPPORTUNITIES (1997).

17. FDIC, General Counsel's Opinion No. 8; **Stored**
Value Cards, 61 Fed. Reg. 40,490 (1996) [hereinafter FDIC
Opinion]. For a comprehensive description of **stored-**
value products and the legal implications of their use, see Task
Force on **Stored-Value** Cards, A.B.A., A Commercial
Lawyer's Take on the Electronic Purse: An Analysis of Commercial Law Issues
Associated with **Stored- Value** Cards and Electronic
Money, 52 Bus. LMw. 653 (1997). 18. 12 US.C. 1813(lj.

19. Sharon Powers Sivertsen, Legal and Regulatory Issues in
Stored Value Card Technologies 9-10 (Feb. 8, 1996)
(unpublished manuscript, on file with The Business Lawyer, University of
Maryland School of Law).

20. 12 U.S...
...gov/showdoc.cfm?index = 14&sequence = 5&from = i >
[hereinafter CBO Study]. Similarly, to the extent that banks participate in
the issuance and distribution of **stored value**, they
may be subject to the operational and reputational risks that will arise if
the issuer of

Footnote:

a **stored-value** system fails; see also Thomas P
Vartanian, Doing Business on the Net Sure to Change Risk Profiles, AM.
BANKER, Feb. 18, 1997, at 18A. 22...

...supra note 21.

DIVISION OF SUPERVISION, FDIC, ELECTRONIC BANKING: SAFETY AND SOUNDNESS
EXAMINATION PROCEDURES (1997) [hereinafter EXAMINATION PROCEDURES (l997)
[hereinafter EXAMINATION PROCEDURES]; see also FDIC, **Stored**
Value Cards and Other Electronic Payment Systems, 61 Fed. Reg.
40,494 (1996). In this notice for public comment, the FDIC stated that

Footnote:

[t]he emergence of **stored value** cards and other
electronic payment systems raises certain safety and soundness concerns for
depository institutions and regulators. For example, institutions must take
steps to ensure that the **stored value** or similar
system in which they are participating has adequate safeguards to prevent
counterfeiting or other fraudulent activities which could harm the
institution, its customers...

...Sivertsen, supra note 19; Thomas P. Vartanian, Key Question for Emerging
Systems: Where is the .,loney Ars. BANKER, June 17, 1996, at 6A; see also
Stored Value Cards and Electronic Payment Systems:
Hearings Before the Federal Deposit Insurance Corporation (Sept. 12, 1996),
available at <http: //www.ffhsj.com/bancmail/tpvtest.htm>; (statement
of Thomas P Vartanian). There are advantages and disadvantages of having

FDIC deposit insurance coverage for **stored-value** or other retail payment products. For example, the bank issuer of an insured SVC could use FDIC coverage as a marketing tool, allowing its products to be promoted as governmentinsured. Covering **stored-value** products with FDIC insurance, however, would add to an institution's deposit base and thus increase the insurance premium paid to the FDIC. Treating the funds as deposits would also eliminate the **stored-value** "float" income that the bank issuer intends to receive from the funds held against future consumer purchases because the FDIC-insured balances would be maintained in consumer accounts, rather than the bank's own account. See FDIC Decides to Look Before It Leaps on Covering **Stored-Value** Cards, BANK NETWORK NEWs, July 26, 1996, at 3 (on file with The Business Lawyer, University of Maryland School of Law) [hereinafter FDIC Decides to...

...same day; the FDIC issued a notice of public hearings and request for comment on the issues contained in the General Counsel's Opinion on **stored-value** cards. FDIC, **Stored Value** Cards and Other Electronic Payment Systems, 61 Fed. Reg. 40,494 (1996). The FDIC had previously issued an opinion on two related topics--deposit insurance...note 17, at 40,492. 31. Id.

32. Id. at 40,493. To the degree that this characterization describes the majority of existing or planned **stored-value** card systems, the FDIC's determination that deposit insurance is unavailable will likely have profound practical implications for potential card issuers. 33. Id. at 40...

...1)).

35. Id. at 40,492 (citing FDIC v. Philadelphia Gear Corp., 476 U.S. 426, 435 (1986)). 36. Id. at 40,494.

37. FDIC, **Stored Value** Cards and Other Electronic Payment Systems, 61 Fed. Reg. 40,494 (1996). The FDIC also solicited comment on the application of deposit insurance issues to Internet banking and a variety of other electronic payment systems as well. "While the discussion of policy considerations below focuses on **stored value** cards, the FDIC staff believes that such policy analysis would in general apply to a variety of electronic payment system issues, including concerns raised by...

...Press Release 44-97 June 24, 1997) (visited Oct. 15, 1997) <http://www.fdic.gov/banknews>; see also Dean Anason, FDIC Will Keep Hands off **Stored-Value** Cards For Now, AMt. BANKER,June 25, 1997, at 2.

40. The FDIC Opinion did not analyze fully the possibility that funds underlying electronic value...

...trust funds" definition of "deposit" in the statute, 12 U.S.C. 1813(l)(2), because the FDIC is not presently aware of any such **stored-value** systems in which funds are held by an institution in a fiduciary capacity. See FDIC Opinion, supra note 17, at 40,493.

Footnote:

41. See...check or telephone transfer Id.
Footnote:

128. Electronic Fund Transfers, 61 Fed. Reg. at 19,698-99; see also Barbara E. Mathews, Reg E and **Stored Value** Cards: Fed Is on Right Track, BANKING POL'Y REP.,July 15, 1996, at 4. 129. Electronic Fund Transfers, 61 Fed. Reg. at 19,701...

...Transfers, 61 Fed. Reg. at 19,704 (to be codified at 12 C.F.R. sec 205. 16(b)(l)) (proposed definition of "off-line **stored** **value** account").

135. See Mathews, supra note 128, at 4.

136. Electronic Fund Transfers, 61 Fed. Reg. at 19,699.

137. Id. at 19,701-02...

...147. Id.

178. Id. at 19,703.

149. Id.

Footnote:
150. Commentary on the FRB's Regulation E proposal includes: Niles S. Campbell, Fed Proposes **Stored-Value** Card Rules;
Regulation E to Cover liew Technology, 66 Banking Rep. (BNA) 498 (1996); Sharon B. Heaton, Comment: The Perils Fed'd.Approach to **Stored** ' **Value**, AMt. BANKER, Apr. 29, 1996, at 18; Lipkin, supra note 133, at B6; Mathews, supra note 128, at 4; Brian Nixon, E-Cash, .tERI(A...

...COMMUNITY B.'KER,June 1996, at 34 (on file with The Business lawyer, University of Maryland School of Law); Ira H. Parker, Comment: Fed's **Stored- Value** Proposal is a Worry for Card Industry, AM. BANKER, Apr. 17, 1996, at 3; **Stored-Value** Issuers Brace for a Reg E Ruling, DEBIT CARD NF.is, July 16, 1996, at 1 (on file with The Business Lawyer, University of Maryland School of Law).

151. See Electronic Fund Transfers, 61 Fed. Reg. at 19,703. The FDIC's recent General Counsel Opinion No. 8 on **stored-value** products utilizes four entirely different categories to identify the treatment of **stored-value** products under the FDIA. See supra note 17 and accompanying text. These categories are (i) bank primary customer account systems; (ii) bank primary-- reserve systems...

...see also Board of Governors of the Fed. Reserve Sys., Report to the Congress on the Application of the Electronic Fund Transfer Act to Electronic **Stored-Value** Products (visited Oct. 15 1997) <http://www.bog.frb.fed.us/boarddocs/RptCongress/> [hereinafter StoredValue Report].

155. EGRPRA 2601(a)(2), 110 Stat. at 3009...

...US.C. 1693-1693r (1994)). 156. Electronic Fund Transfers, 61 Fed. Reg. at 19,696. 157. EGRPRA 2601(c), 110 Stat. at 3009-469.

158. **Stored-Value** Report, supra note 154. For purposes of the **Stored-Value** Report, the FRB defined SV products as retail payment products intended primarily for consumer payments with some or all of the following characteristics: (i) it...7. The OCC had also approved, at the time the Mondex letter was issued, the establishment and operation by a national bank of a closed **stored-value** system on a university campus. See OCC Interpretive Letter No. 737, [1996-1997 Transfer Binder] Fed. Banking L. Rep. (CCH) Sj 81,101 at 90...OCC Banking Bulletin 96-48 also referred to the general types of risks described in the OCC Supervision by Risk program which are present in **stored-value** systems (i.e., transaction, strategic, reputation, compliance, credit, liquidity, interest rate, and foreign exchange risks). Id. at 54,919-21.

251. The OTS was created...by Messrs. Vartanian and Ledig, scheduled for release in early 1998.
Mr. Ledig is a member of the American Bar Association's Task Force on

Stored-Value, which published A Commercial Lawyer's
Take on the Electronic Purse, in the February 1997 issue of The Business
Lawyer. He is a Lecturer in...

Descriptors:
...**Stored value** cards

Classification Codes:

View: HTML | PDF | Word

☐ The perils in Fed's approach to **stored**1 **value**1.(Federal Reserve Board and **stored**1 **value**1 smart cards)(Column)

Date: April 29 , 1996

11/6,K/4 (Item 4 from file: 148)
08623210 **Supplier Number:** 18231937 (USE FORMAT 7 OR 9 FOR FULL TEXT)
The perils in Fed's approach to **stored value**.(Federal Reserve Board and **stored value** smart cards)(Column)

April 29 , 1996
Word Count: 1271 **Line Count:** 00104
The perils in Fed's approach to **stored value**.(Federal Reserve Board and **stored value** smart cards)(Column)

Abstract: Developments in the **stored value** "smart card" market are difficult to predict. Smart cards could be legally defined as bank deposits, and changes in the law has hazards for these products. The Federal Reserve Board is amending Regulation E, and has asked for comments concerning further changes which could affect **stored value** cards There are also risks in the Fed's approach concerning off-line and on-line card distinctions.

Abstract:

Text:

Stored value cards have recently generated considerable attention.

On April 10, Citibank, Chase Manhattan, **MasterCard**, and Visa announced an initiative in which 50,000 reloadable **stored value** smart cards will be issued for use with 500 retail vendors on the Upper West Side of Manhattan. And Visa has announced plans to promote...

...one hand, current law could have the unintended effect of impeding the development of these new technologies and services.

For example, the purchase of a **stored value** card from a bank may resemble the making of a bank deposit, as that term in defined in federal law. If the purchase is a...

...the Federal Reserve has directly confronted these dual concerns. Currently, the agency's Regulation E contains provisions that would impose costly and impractical requirements on **stored value** cards, such as transaction receipts and periodic statements.

After two years of consideration, the Federal Reserve adopted On March 20 a final rule amending Regulation E, but did not deal with the issues raised by **stored value** cards. At the same time, however, the Federal Reserve released for comment proposed amendments to Regulation E to address **stored-value** cards specifically. Comments are due by July 10.

The purpose of the proposed amendment is to ensure that inappropriate regulation does not impede the development of **stored value** cards. In a memo to the board, the staff noted that disparate regulatory treatment of different types of **stored value** cards could create incentives for issuers to design their systems in particular ways to avoid being covered by Regulation E. Specifically, the staff wrote "(i...

...advanced by the board is likely to have this very effect.

In its proposed regulation, the Federal Reserve lists three categories of system design for **stored value** cards, each of which would be regulated differently under the board's proposal.

In "off-line unaccountable **stored-value** systems," the card's value is maintained only on the card itself. Transaction data for debits to the card's "**stored-value**" are recorded on the card and captured at the merchant terminals. Only the aggregate amount of transactions for a given period is transmitted by the merchant to the financial institution so that the merchant can receive credit.

In "**off-line** accountable **stored-value** systems," the **balance** of funds available is recorded on the card, but is also maintained at a central data facility. There is no on-line authorization of transactions, but transaction data is periodically transmitted to and maintained by a data facility.

In "on-line **stored-value** systems," there is on-line access to a data base for purposes of transaction authorization and data capture. The card itself is not "smart" - the...

...except that the value associated with a card is limited to the amount that the cardholder has specified.

The staff recommended that off-line unaccountable **stored value** systems be entirely exempt from Regulation E. Off-line accountable and on-line systems would be exempt if the maximum amount that could be associated with the card at any given time is $100 or less. Off-line accountable **stored value** systems with cards over $100 would be exempt from all of Regulation E except for requirements related to initial disclosures.

In contrast, on-line systems...

...annual error resolution notice requirement.

* Change-in-terms notices.

The Federal Reserve solicited comments on whether the proposed modifications should be different for on-line **stored-value** cards that are "reloadable" as opposed to disposable.

By segregating **stored value** cards into three categories and proposing different regulation for each, the Federal Reserve may be heading down the path it seeks to avoid - having regulatory...

...100 or less in value to avoid Regulation E. If the issuer seeks to issue cards above $100, there would be a strong incentive to **limit** such cards to **off-line** unaccountable **stored value** systems.

The weakness of this approach is particularly apparent for on-line cards. For instance, if Regulation E imposes one set of rules on disposable ...

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Records: 1 to 4 of 4

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